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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1979

No. 78-1201

MOBIL OIL CORPORATION,
Appellant,

vs.

COMMISSIONER OF TAXES OF VERMONT,
Appellee.

On Appeal From the Supreme Court of Vermont

Brief Amicus Curiae in Support of Appellee, The Commissioner of Taxes of Vermont, Submitted on Behalf of Standard Oil Company of California

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PRELIMINARY STATEMENT

Pursuant to Rule 42(2) of the Rules of this Court, this amicus curiae brief in support of appellee is filed with the written consents of appellant and appellee, on file with the Clerk of this Court.

INTEREST OF AMICUS CURIAE

Standard Oil Company of California ("Standard") is a Delaware corporation engaged in essentially the same business as Mobil Oil Corporation ("Mobil"), the appellant in this case. Standard and its subsidiaries conduct an integrated petroleum business throughout the world. As does Mobil, Standard owns a percentage interest in and

has derived dividends from Arabian American Oil Company ("ARAMCO"), a domestic corporation engaged in crude oil production in Saudi Arabia. ARAMCO constitutes a major source of crude oil supplies for Standard's unitary petroleum business.

In the instant case, Mobil argues that New York as the state of its commercial domicile should have the sole and exclusive power to tax all of its dividend income including ARAMCO dividends without any showing that its stockholdings or its dividend income are unrelated to its unitary petroleum business part of which is carried on in Vermont.

Unlike Mobil, Standard maintains the commercial domicile of its unitary business operations in California. In 1967, California adopted as part of the California Bank and Corporation Tax Law (Cal.Rev. & Tax. Code, § 23101, et seq.) the provisions of the Uniform Division of Income for Tax Purposes Act ("UDITPA") which provide for the apportionment of income, including income from intangibles such as dividends, among the various states where the taxpayer conducts its unitary business operations, to the extent that income constitutes "business income" as defined by the Act.

Standard is presently involved in an appeal before the California State Board of Equalization which presents the question whether the dividends received by it from ARAMCO in 1967 constitute apportionable "business income" under the California UDITPA provisions. Standard is contending that these provisions must be construed to require apportionment of all income derived from business-related intangible property, including dividends from jointly held supply companies such as ARAMCO, consistent with the interpretation placed on such provisions by the vast majority of UDITPA states.

Although Vermont's net income tax provisions differ from those of UDITPA, Standard is concerned with Mobil's contention that only the state of "commercial domicile" has the power to tax its ARAMCO and other "foreign source" dividends. Such a contention, if accepted, would severely impair the proper application of UDITPA in California and the other states that have adopted the uniform apportionment and allocation rules contained therein. It also necessarily would foreclose the rights of all nonheadquarter states where a corporate taxpayer conducts substantial business activities from including business-related dividend income in the net income tax base subject to apportionment.

SUMMARY OF THE ARGUMENT

There is no substance to Mobil's due process "nexus" argument. Repeated decisions of this Court have affirmed that where a corporation conducts an integrated or unitary business within as well as without the boundaries of a taxing state, that state is not bound by the artificialities of separate accounting for particular items of income, but may base its tax on a fairly apportioned share of the entire net income generated by that business. Absent "clear and cogent" evidence to the contrary, it must be assumed that such an apportioned net income tax does not reach extraterritorial values, but only income fairly attributable to that part of the business conducted within the taxing state.

In the instant case, Mobil makes no effort to challenge the fairness of Vermont's apportionment formula. Rather it asserts that certain income must be excluded from Vermont's apportionable net income base merely because of the form of the income, i.e., dividends received by Mobil from its operating subsidiaries and affiliates. Mobil asserts that the stock of these subsidiaries and affiliates is "held" and "managed" outside Vermont. But where such stock is formally "held" or "managed" or where dividends are "received" are purely matters of form having no constitutional significance. Mobil has presented no evidence that could support an inference that its acquisition and management of the stocks of its operating subsidiaries and affiliates were unrelated to its unitary petroleum business conducted in part within the State of Vermont. There is nothing in the record to support Mobil's suggestion that such stockholdings were "passive investments" unrelated to its unitary petroleum business. That being true, Mobil's due process argument has no substantial basis.

The specific allocation approach advocated by Mobil artificially allocates a class of business-related income to the state where a corporation maintains its "commercial domicile" on the basis of an archaic legal fiction. As a matter of due process, this approach is far less defensible than the fair apportionment of such income to all states in which the integrated business activities of the taxpayer are conducted.

Mobil's commerce clause argument is based on a misconstruction of this Court's decision in *Japan Line, Ltd.* v. *County of Los Angeles* (April 30, 1979) 47 U.S. Law

Week 4477. *Japan Line* expressly was limited to a state ad valorem property tax imposed directly on foreign owned and based shipping containers used exclusively as instrumentalities of foreign commerce. This Court viewed such a state property tax as a regulation of foreign commerce which was inconsistent with clearly established Federal policy.

In contrast, a properly apportioned state income tax, such as that of Vermont, involves no regulaton of foreign commerce or its instrumentalities, no inconsistency with Federal policy, and no danger of forbidden duplicative taxation. By its very nature, such a tax is not intended to and does not reach foreign instrumentalities, activities or income, but is confined to a share of the corporation's income fairly attributable to its domestic activities within the borders of the taxing state. No Federal treaty or statute has ever been thought to restrict the ability of the states to impose properly apportioned net income taxes on income fairly attributable to activities within their borders in addition to any income taxes imposed on the worldwide income of a domestic corporation at the national level.

Mobil acknowledges that there is no basis for immunizing the dividend income in question from *any* state taxation by virtue of its alleged "foreign source" as would be true if the holding of *Japan Line* were in point. To the contrary, it affirmatively argues that the state of commercial domicile possesses the power specifically to allocate and tax the *entire* dividend income in question. Mobil's concern is not with overlapping state and national or for-

eign taxation, but with duplicative income taxation *among the states* as a result of inconsistent rules of apportionment and allocaton. On this record, however, Mobil's fears of such duplicative taxation are entirely speculative and hypothetical, because Mobil has made no effort to establish any such overlapping or duplicative taxation of the income in question. Mobil's hypothetical fear of duplicative taxation thus presents no commerce clause issue beyond that already considered and disposed of in *Moorman Mfg. Co.* v. *Bair* (1978) 437 U.S. 267.

ARGUMENT

I. MOBIL'S DUE PROCESS ARGUMENT ELEVATES FORM OVER SUBSTANCE AND DISREGARDS REPEATED DECISIONS OF THIS COURT SUSTAINING PROPERLY APPORTIONED STATE NET INCOME TAXES.

Insofar as it rests on the due process clause, Mobil's argument that the dividends in question have no "nexus" with Vermont for net income tax apportionment purposes ignores settled decisions of this Court, elevates form over substance, and is in any event without support in the record.

The Vermont tax in question does not attempt to tax "New York dividends" as such, any more than it separately taxes any other item of the gross income or receipts of Mobil Oil Corporation. Instead, it seeks to reach only the *net income* of the corporation properly attributable to its activities carried on within the State of Vermont. Because Mobil conducts an integrated petroleum business which is carried on within as well as without the State of Vermont, the Vermont tax is by necessity imposed only upon that

portion of the net income of the corporation "allocated or apportioned to this state" (32 Vt.Stat.Ann., § 5832(1)) under a conventional three-factor apportionment formula.[1] This apportionment method expressly is designed to "allocate to this state a fair and equitable portion of [the corporation's net] income" (id., § 5833(a)) and is subject to modification if the taxpayer demonstrates that the portion of its income attributed to the state "does not fairly represent the extent of the business activities of [the] corporation within this state" (id., § 5833(b)).[2]

The validity of an apportionment method for attributing net income to a taxing jurisdiction has been sustained by numerous decisions of this Court, which are controlling here. In *Underwood T'writer Co.* v. *Chamberlain* (1920) 254 U.S. 113, the corporate taxpayer offered evidence that virtually all of its net profits had been "received" in states other than Connecticut, which had nonetheless apportioned 47% of the corporation's entire net income to its operations within that state. Sustaining the tax, Mr. Justice Brandeis noted that the state "was faced with the impossibility of allocating specifically the profits earned by the

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[1]The formula apportions Mobil's income to Vermont on the basis of the ratios of Mobil's property, payroll, and sales in Vermont to its property, payroll, and sales everywhere.

[2]The quoted provisions were those in effect during the tax years in question. In the case of Vermont, for the year 1972, Vermont's three-factor apportionment formula based on property, payroll, and sales in the State of Vermont as compared with those of Mobil everywhere, attributes less than two-tenths of one per cent or only .18% of Mobil's Federal taxable income (which was in excess of $232 million) to Mobil's Vermont operations thereby producing a tax of approximately $25,000 (App., p. A79). In contrast, by excluding its dividends from apportionable net income, Mobil reported an apportionable loss from its domestic operations, and accordingly paid the minimum Vermont tax of $25 for 1972.

processes conducted within its borders" (254 U.S. 121). Therefore it "adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State" (ibid.).

And in *Bass, Etc., Ltd.* v. *Tax Comm.* (1924) 266 U.S. 271, this Court for the same reason sustained New York's apportionment of a percentage of the net income of a British corporation selling ale in New York, even though the corporation had reported no taxable income for Federal income tax purposes, but had attributed its income entirely to foreign sources (266 U.S. 279). Against the taxpayer's contention, much the same as that of Mobil in the instant case, that the tax was not based on its New York business but upon its "net income derived from business carried on outside of the United States" (266 U.S. 280), this Court observed that the corporation "carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places" (266 U.S. 282). "The fact that the Company may not have had any net income upon which it was subject to payment of income tax to the Federal Government, obviously does not show that it received no net income from the business which it carried on in New York" (266 U.S. 283).

Over 35 years ago in *Butler Bros.* v. *McColgan* (1942) 315 U.S. 501, this Court explained why the artificialities of separate accounting could not be allowed to impede a state's effort to tax a share of a corporate taxpayer's net income fairly attributable to its activities conducted and protection received within the state. Although the tax-

payer's books showed a net loss for its California operations (315 U.S. 505), this Court held that it had not carried its "distinct burden of showing by 'clear and cogent evidence' that [the apportionment formula] results in extraterritorial values being taxed" (315 U.S. 507). As to the separation of income shown in the taxpayer's accounts, this Court explained:

> "It is true that appellant's separate accounting system for its San Francisco branch attributed no net income to California. But we need not impeach the integrity of that accounting system to say that it does not prove appellant's assertion that extraterritorial values are being taxed. Accounting practices for income statements may vary considerably according to the problem at hand [citation omitted]. A particular accounting system, though useful or necessary as a business aid, may not fit the different requirements when a State seeks to tax values created by business within its borders. * * * [T]he particular system used may not reveal the facts basic to the State's determination" (315 U.S. 507-508).

Although the question of the inclusion of dividends in apportionable income was not specifically presented in *Butler Bros.*, its reasoning is fully applicable. This Court's rejection of any constitutional requirement for "separate accounting" applies equally to Mobil's argument for specific allocation of intangible income, such as dividends, to a fictional "situs" under the outmoded doctrine of *mobilia sequuntur personam*, which is only a variation on the theme of separate accounting. The fact that Mobil has chosen to carry on part of its worldwide petroleum business through controlled subsidiaries from which it receives

dividends, rather than through divisions, is not a difference of constitutional dimension. To reach that conclusion would truly be a "triumph of formalism over substance" (*Complete Auto Transit, Inc.* v. *Brady* (1977) 430 U.S. 274, 281). A corporation's ability to arrange its corporate affairs to receive a substantial portion of its business income in the form of dividends from controlled subsidiaries cannot affect the underlying business reality(see J. R. Hellerstein, The Unitary Business Principle and Multicorporate Enterprises, 27 Tax Executive 313, 317-318).

Although uniform rules for the division of income for state tax purposes are still in the evolutionary process, the vast majority of states which have enacted a net income tax include business-related dividends in a corporate taxpayer's apportionment base, without regard to the fact that the underlying stock may be held or managed outside of the taxing state. Such an approach is consistent with that advocated by Jerome R. Hellerstein, Esq., a prolific author in the state taxation area, when he testified before the Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance in 1973. In opposing a bill (S. 1245) which would have excluded dividends from the apportionable tax base, and to the extent received from "foreign sources," excluded them from state taxation altogether, Professor Hellerstein observed in 1973 that:

> "[I]f a manufacturing company receives dividends from its wholly-owned subsidiary which is engaged principally in selling the product of the parent company, the dividends constitute a part of the profits derived from the parent-subsidiary unitary business. *Such profits constitute operating income, income of*

> *the business, just as they would if the enterprise were conducted through sales branches, instead of a subsidiary. Such dividends ought to be apportioned as part of the basic operating income of the enterprise* * * *" (Hearings (September 18 and 19, 1973) 93d Cong., 1st Sess., p. 163) (emphasis supplied).

To be sure, this approach, consistent with the provisions of the Uniform Division of Income for Tax Purposes Act, advocates only that "business" as opposed to "non-business" dividends be subject to apportionment and that "non-business" dividends be allocated to the state of commercial domicile (UDITPA, §§ 1(a), 1(e), 4, 7). Under UDIPTA, income from tangible and intangible property, including dividends on stock, constitutes "business income" subject to apportionment if "the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations" (§ 1(a)). Similarly, the regulations of the Multistate Tax Commission under UDIPTA provide, with respect to dividend income, that:

> "Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the stock is related to or incidental to such trade or business operations" (Multistate Tax Commission Allocation and Apportionment Regulations (February 21, 1973) § IV.1.(c).(4)).

In an apparent effort to invoke the "business," "non-business" distinction, Mobil asserts that "the activities, personnel and property of Mobil in Vermont, in which only the marketing of petroleum and related products was con-

ducted, have nothing to do with Mobil's holding of stocks in foreign subsidiaries or affiliates or its foreign investments, or the dividend income they produce" (Appellant's Br., p. 10), and characterizes its activities with respect to its stock and dividends as its "business * * * as a holding and investing company" (id., p. 31).

However, Mobil has introduced no evidence to support an assertion that the dividends in question have no relation to its unitary petroleum business a part of which is carried on in Vermont, but are merely the product of unrelated passive investments. The only support offered by Mobil in support of its unrelated "investment income" characterization is a reference to certain paragraphs (7, 11, 26-27) of a document which it describes as a "Stipulation of Facts" (Appellant's Br., pp. 4-5, 9). This document which is contained in the Appendix (pp. A79-A91) was not a stipulation, but was a unilateral statement submitted by Mobil in the state tax proceedings. It contains the following description of the stocks, dividends and income in question:

> "The aforementioned capital stocks were held, managed and controlled by Mobil from its offices outside Vermont. Payment of all dividends was received by Mobil outside Vermont and Mobil's control, use and disposition of such dividends were managed and directed from Mobil's offices outside Vermont" (App., p. A83, par. 11).
>
> "More than 99% of the dividends here in issue were received from corporations deriving all or all but an insignificant portion of their income from sources outside the United States" (App., p. A88, par. 26).

But whether the stock certificates of the subsidiaries in question were "held" or "managed" by Mobil outside of the State of Vermont, or whether the earnings out of which the dividends were paid had a foreign or domestic "source," are irrelevant to the due process issue now before the Court, *because those "facts" say nothing about the relationship of the stockholdings or the companies from which the dividends were paid to Mobil's integrated, unitary petroleum business* conducted within as well as without the State of Vermont. The careful phraseology of Mobil's unilateral "Stipulation" is noteworthy primarily *because* of its studious omission of the slightest mention of the nature of the business activities of the subsidiaries from whose earnings the dividends were received, or the relationship of its stockholdings to the petroleum business conducted by Mobil in Vermont and elsewhere in the United States. It is only if there were no such relationship at all that the due process "nexus" issue that Mobil seeks to raise could be presented for resolution by this Court.

Mobil's citation of such cases as *Wheeling Steel Corp.* v. *Fox* (1936) 298 U.S. 193, ostensibly in support of the rule that the state of commercial domicile and *only* that state has the right to tax its intangibles (Appellant's Br., pp. 10, 31), disregards the fundamental distinction between the *property* taxes involved in those decisions and the tax on apportioned net income here. Even in the property tax area, this Court has recognized far more leeway for state taxation of intangibles than Mobil acknowledges. In the *Wheeling Steel* case, this Court recognized that intangibles which are integral parts of a local business may acquire

a "business situs" supporting their taxation for property tax purposes at other than the legal domicile of their owner (298 U.S. 210). And this Court has long sustained the determination of local property or corporate franchise values by reference to the value of intangible property utilized in the business of the taxpayer without regard to its alleged "location" outside the taxing state (*Ford Motor Co.* v. *Beauchamp* (1939) 308 U.S. 331, 335-336; *Adams Express Company* v. *Ohio* (1897) 166 U.S. 185, 222). In *Curry* v. *McCanless* (1939) 307 U.S. 357, this Court rejected the contention that notions of "fictitious situs" (307 U.S. 369) of intangibles which in reality have "no physical characteristics" and may be "associated in numerous intimate ways" (307 U.S. 362-363) with a number of states can limit the taxation of intangibles to a single jurisdiction. To the contrary:

> "[W]hen the taxpayer extends his activities with respect to his intangibles, so as to avail himself of the protection and benefit of the laws of another state, in such a way as to bring his person or property within the reach of the tax gatherer there, the reason for a single place of taxation no longer obtains, and the rule is not even a workable substitute for the reasons which may exist in any particular case to support the constitutional power of each state concerned to tax" (307 U.S. 367).

Further:

> "We find it impossible to say that taxation of intangibles can be reduced in every case to the mere mechanical operation of locating at a single place, and there taxing, every legal interest growing out of all the complex legal relationships which may be entered into between persons. This is the case because in point of actuality those interests may be too diverse in their relationships to various taxing jurisdictions to admit of unitary treatment * * *. The Fourteenth Amendment cannot be carried out with such mechanical nicety without infringing powers which we think have not yet been withdrawn from the states" (307 U.S. 373).

In any event, Mobil's argument fundamentally fails to deal with the fact that the Vermont income tax is not a tax *on* the intangibles themselves (in which event it might be argued that the state in which such rights are "held" or managed may have some independent basis for taxation by virtue of that fact alone). Rather, the Vermont tax is a tax on the net income of the corporation properly apportioned to its activities in Vermont. In the *Wheeling Steel* case itself, this Court recognized that property tax notions of "situs" or "location" are beside the point in the present context:

> "The tax is not on the net profits of a unitary enterprise demanding a method, not intrinsically arbitrary, of making an apportionment among different jurisdictions with respect to the processes by which the profits are earned. *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113, 120, 121; *Bass, Ratcliff & Gretton, Ltd.* v. *State Tax Comm'n*, 266 U.S. 271, 282, 283; *Hans Rees' Sons* v. *North Carolina, supra.* Such a tax on net gains is distinct from an *ad valorem* property tax on the various items of property owned by the Corporation and laid according to the location of the property within the respective tax jurisdictions" (298 U.S. 212) (emphasis in original).

This Court has made clear that the fact that intangibles may be viewed under some conceptions as "located" outside

the taxing jurisdiction in no way precludes the fair apportionment of income or values associated with those intangibles to the jurisdiction where the business activities of the corporation have been conducted and where, accordingly, that income or value may fairly be said to have arisen (*Harvester Co.* v. *Dept. of Taxation* (1944) 322 U.S. 435). Nor is it of constitutional significance that the taxpayer has arranged for its stock to be "held" or "managed" outside the taxing jurisdiction, or that its dividend income is formally "received" there, as Mobil alleges. "The fact that a tax is contingent upon events brought to pass without a state does not destroy the nexus between such a tax and transactions within a state for which the tax is an exaction" (*Wisconsin* v. *J. C. Penney Co.* (1940) 311 U.S. 435, 445).

Such facts as there are in the record make it quite clear that the dividends in question were not the product of mere passive investments in stocks and businesses unrelated to Mobil's unitary petroleum business, but were integrally related thereto. Even putting aside the fact that the dividends in question constituted a significant component of Mobil's taxable Federal income (App., p. A83), the subsidiaries from which the dividends were received are repeatedly characterized as "operating subsidiaries" in Mobil's own unilateral "Stipulation" (App., pp. A84-A87, A89-A90). The primary payors of the dividends in question are specifically identified in the record as including "Mobil Marine Transportation Limited," and two major sources of foreign crude production, "Mobil Oil Iraq with Limited Liability," and the "Arabian American Oil Company" (App., pp. A75-A76). Mobil does not disclose the precise nature of the business conducted by these and its other dividend-paying

subsidiaries and affiliates, but obviously there is no basis for assuming that these "investments" are unrelated to Mobil's petroleum business. To the contrary, in a description of its business filed in connection with a California action in which Mobil is claiming a refund of California franchise taxes, Mobil points out that:

> "The Taxpayer also imported crude oil for use by its various refineries in the United States outside California from certain of its foreign subsidiaries. The total amount of crude oil used in the refineries of the Taxpayer within the United States which was purchased from its foreign subsidiaries or non-affiliated companies and was derived from sources outside this country accounted for approximately 18%, 22%, 26%, 21% and 28% of its refinery runs in the United States for the respective years 1967, 1968, 1969, 1970 and 1971" (*Mobil Oil Corporation* v. *Franchise Tax Board of the State of California*, San Francisco Superior Court No. 723-863, Exh. 1 to Complaint, p. 14).
>
> "During the years 1967-1971 most of the Taxpayer's ocean tanker fleet was operated under foreign flag and was owned by some sixteen foreign subsidiaries as defined in I *supra*. * * * To the extent that the Taxpayer's United States operations used foreign crude oil, such crude was transported by this fleet" (id., p. 24).

In this setting, Mobil's contention that all of its dividend income must be specifically allocated to the state of commercial domicile is entirely unfounded. As a matter of due process, the state in which a multistate or multinational corporation maintains its commercial domicile has no greater claim for taxing dividends received from stock held in connection with the corporation's unitary business than any other state in which that unitary business is conducted.

Due process is served, not hindered, by the use of the apportionment formula in assigning dividends, interest, royalties or other income from business-related intangibles for state income tax purposes. Indeed, this is a far more reasonable method from a due process standpoint than artificially allocating such income in full to a single state simply because the business headquarters or management staff of the corporation happens to be located there. The "commercial domicile" rule for assigning a taxable situs to intangibles has its historical origin in a legal fiction, the doctrine of *mobilia sequuntur personam,* which if arbitrarily applied to state net income taxes would unjustifiably favor the state of commercial domicile at the expense of other states where substantial business activities are conducted. As a number of "corporate headquarters" states such as New York impose reduced or no income taxes on such dividend income, to sustain Mobil's contention would inevitably lead to the insulation of large portions of the business income of corporate taxpayers headquartered in such jurisdictions from income taxation by any state.

The record demonstrates that Mobil was engaged in integrated business activities within and without the State of Vermont. In arriving at its Vermont net income tax base, Mobil deducted in full the salaries of management personnel working at its business headquarters in New York, as well as the salaries and wages of all other unitary business employees. Mobil also deducted all other business expenses including those incurred in the New York phase of its unitary business. The state of commercial domicile is certainly entitled to its properly apportioned share of the net income of a multistate corporate taxpayer. However, Mobil's assertion that New York, as the state

of commercial domicile, should be entitled specifically to allocate and tax 100% of its dividend income to the exclusion of all other states in which substantial business activities are conducted runs contrary to the fundamental due process goal of fairly distributing the net income of a multistate corporate business among all states having jurisdiction to tax.

II. MOBIL'S COMMERCE CLAUSE ARGUMENT BASED ON DUPLICATIVE STATE TAXATION RESTS ON SPECULATION AND IS FORECLOSED BY THIS COURT'S DECISION IN MOORMAN MFG. CO. v. BAIR (1978) 437 U.S. 267.

Mobil's commerce clause argument rests on a series of erroneous assumptions: (1) that Vermont's efforts to tax a fairly apportioned share of a domestic corporation's net income should be treated as an attempt by Vermont to levy a tax on the foreign income of the foreign subsidiaries of that corporation; (2) that the direct ad valorem property tax on foreign-owned, registered, and based instrumentalities of foreign commerce involved in *Japan Line, Ltd.* v. *County of Los Angeles* (April 30, 1979) 47 U.S.Law Week 4477 should be equated with the tax on an apportioned share of a domestic corporation's net income here involved; (3) that, although admittedly none has been shown to exist in the instant case, this Court would be without power to prevent duplicative state taxation of income derived from foreign commerce should it arise; and (4) that the state of "commercial domicile" has the power (concededly not exercised in the instant case) to tax all of the dividends in question without regard to the relationship of the stocks or activities from which they were derived to the overall multistate business activities of the taxpayer.

In *Moorman Mfg. Co.* v. *Bair* (1978) 437 U.S. 267, this Court reaffirmed its consistent holdings that a claim that an apportioned state net income tax violates the commerce clause must rest on a showing of *actual,* not "speculative," duplicative taxation (437 U.S. 276); that a state's apportionment formula is "presumptively valid" (437 U.S. 277); and that in view of "the legislative power granted to Congress by the Commerce Clause," it was "to that body, and not this Court," that the Constitution commits the task of enacting uniform rules for the division of income (437 U.S. 280).

The result in the instant case is a simple one after *Moorman,* because Mobil has made no effort to demonstrate any duplicative state taxation of the dividend income in question—indeed it concedes that New York, which it asserts to have the exclusive right to tax its dividend income as the state of "commercial domicile," effectively imposes no tax at all on such dividends (Appellant's Br., p. 33). And whereas the "single-factor" apportionment practice upheld in *Moorman* was decidedly out-of-step with that followed in most other states, the practice of apportioning some or all dividend income to the states in which a corporation does business, at least absent some showing that the stockholdings from which the dividends are derived are unrelated to the unitary business of the taxpayer conducted in part within the taxing jurisdiction, is followed by most states. Mobil's own brief acknowledges that at least 27 of 34 states which include such dividends in the tax base apportion the dividends if they are classified as "business" dividends (Appellant's Br., p. 27; App., p. 4a). Although Mobil asserts that eight of those jurisdictions

including Vermont also apportion "non-business" dividends, that issue is not presented here. As pointed out (supra, pp. 6-7), Vermont's statutory scheme is expressly designed to reach only income which "fairly represent[s] the extent of the business activities of [the] corporation within this state" (32 Vt.Stat.Ann., § 5833(b)), and Mobil has introduced *no* evidence that would support the conclusion that the dividends in question are unrelated to its unitary petroleum business conducted in part in Vermont.

Nor does the alleged "foreign source" of the dividends in question (Appellant's Br., pp. 7, 38, et seq.) lead to a different result.[3] In *Bass, Etc., Ltd.,* v. *Tax Comm.* (1924) 266 U.S. 271, this Court, in a holding that has been unquestioned since, concluded that although a British corporation had attributed its income entirely to *foreign* sources for Federal income tax purposes, the foreign commerce clause presented no barrier to taxation on a fairly apportioned basis of that allegedly "foreign" income by the State of New York, where the corporation carried on sales activities as part of its unitary business. The result here follows *a fortiori,* for Vermont seeks only to tax a share of the net income of a domestic corporation, fairly apportioned to its retail marketing operations within Vermont.

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[3]As pointed out below (infra, pp. 27-32), the Internal Revenue Code, solely for the purpose of *determining income tax liabilities at the national level,* contains definitions of domestic and foreign source income (I.R.C., §§ 861, 862) which are relevant primarily in computing the amount of the credit allowed against the Federal income tax for foreign income taxes paid (I.R.C., §§ 901, 904). Clearly a state has the power to impose a reasonably apportioned net income tax on a corporation conducting business therein in addition to and distinct from income taxes imposed at the Federal level.

Vermont is not attempting to reach beyond its borders to tax the entire net income of Mobil, let alone to tax the separate income of Mobil's foreign operating subsidiaries. Vermont seeks to reach only a share of the net income of Mobil itself, fairly apportioned to Mobil's activities within the State of Vermont. The fact that Mobil receives a large share of its income in the form of dividends from foreign operating subsidiaries or affiliates does not mean that Vermont's apportioned tax is levied on "foreign" income. Because the tax is by definition apportioned to activities within the taxing state, it must be assumed, absent any "clear and cogent" evidence to the contrary (which Mobil has made no effort to present), that only income attributable to Mobil's business and activities within Vermont is taxed.

This Court's decision in *Japan Line, Ltd.* v. *County of Los Angeles* (April 30, 1979) 47 U.S.Law Week 4477, relied on principally by Mobil in support of its commerce clause argument (Appellant's Br., pp. 14, 23-26) is not in point. *Japan Line* did not involve a net income tax properly apportioned to activities within a state, but an *ad valorem* property tax levied directly on foreign-owned cargo containers used exclusively as instrumentalities of foreign commerce. In *Japan Line* this Court specifically noted that "the question here is a * * * narrow one, that is, whether instrumentalities of commerce that are owned, based, and registered abroad and that are used exclusively in international commerce, may be subjected to apportioned ad valorem property taxation by a State" (47 U.S.Law Week 4480). As the containers had already been subjected to a property tax on 100% of their value in Japan, a tax which

the Japan Government had the right to impose (47 U.S. Law Week 4482) and which this Court was powerless to prevent (id., p. 4481), the levying of even an apportioned property tax by the states on the very same instrumentalities of foreign commerce served to ensure that appellants "'would be paying a double tax'" (id., p. 4482) on the containers.

Thus, in *Japan Line*, state ad valorem taxation of containers could not exist without duplicating Japan's property tax, the imposition of which was beyond the control of this Court or the Congress. In contrast, a properly apportioned state net income tax, by its very nature, does not reach foreign income or duplicate foreign taxes assessed against such income. Recognizing that fact, Mobil does not argue that its allegedly foreign source dividends should be free from *any* income taxation at the state level but rather urges this Court to hold that the entire dividend income in question may be taxed exclusively by the state of commercial domicile (Appellant's Br., pp. 29-31).

Given Mobil's contention that the foreign commerce clause does not preclude the state of commercial domicile from taxing dividends received from domestic or foreign subsidiaries and affiliates in full, it is difficult to see how the speculative possibility that conflicting apportionment formulas among the states may in hypothetical situations—not present here—produce some duplicative taxation among the states raises any issue of constitutional dimension beyond that already considered and disposed of in *Moorman* (437 U.S. 276-277). The time to deal with multiple state taxation of income arising from the conduct of foreign commerce as a result of conflicting or overlapping state apportionment

and allocation formulas will arise when the taxpayer has demonstrated such a result in the particular case. "[E]rrors of apportionment that may lead to multiple burdens may be corrected when they occur" (*Washington Rev. Dept.* v. *Stevedoring Assn.* (1978) 435 U.S. 734, 746). This Court most assuredly *can* referee the competing claims of states to tax income fairly attributable to domestic operations within their respective borders wherever the taxpayer can demonstrate that the apportionment and allocation procedures of a particular state, either alone or in combination with those of other jurisdictions, actually result in the duplicative taxation of income arising from interstate or foreign commerce (*Moorman Mfg. Co.* v. *Bair* (1978) 437 U.S. 267, 281). There is no such evidence here.

In this connection, Mobil's fear that particular dangers of duplicative state taxation are present with respect to its dividend income because of "the power of the state of a corporation's commercial domicile to tax the corporation's dividends, without apportionment" (Appellant's Br., pp. 29-30), is not only hypothetical on the present record, *but disregards the fact that this Court has never accepted such a sweeping proposition.* Even in the property tax area, the "commercial domicile" rule has had to yield to apportionment. In *Standard Oil Co.* v. *Peck* (1952) 342 U.S. 382, Ohio contended that the taxpayer's barges were taxable entirely in the state of commercial domicile, despite their extensive business operations elsewhere. This Court reasoned that because the other states in which the corporation did business had the right to tax the barges on an apportioned basis, "the rule which permits taxation by two or more states on an apportioned basis precludes taxation of all of the property by the state of domicile" (342 U.S. 384).

Moreover, this Court has never held that the state of commercial domicile may impose an unapportioned net *income* tax on income merely because it has been received in the form of dividends on stock, without regard to the relationship of such stockholdings to the business operations of the taxpayer in other jurisdictions. Nor is it likely that the Court would accept such a proposition which is contrary to the modern trend of fairly dividing the net income of a multistate corporation among all states having jurisdiction to tax.

The threat of an undue burden on foreign commerce from state income taxation would be much greater if, as Mobil suggests, the state of commercial domicile were allowed specifically to allocate to itself 100% of "foreign source" dividends for state income tax purposes. Under apportionment, the state tax base is *net* income, which permits the gross income of a corporation from business-related dividends or other sources to be reduced by losses or other deductible expenses in arriving at the net income subject to apportionment.

In contrast, the specific allocation approach advocated by Mobil could result, in effect, in a tax on *gross* income or receipts, because a corporation's business-related dividend income would be dissociated from its business-related expenses and arbitrarily assigned entirely to the state of commercial domicile. Under Mobil's approach, as under a gross receipts tax, a corporation domiciled in a state which (unlike New York) includes the full amount of such dividend income in the tax base could face a substantial tax burden even though it had sustained a loss on its overall business operations. For example, a corporation sustain-

ing $2 million of operating losses and receiving $1 million of foreign source dividends or interest income would be subjected to a tax on virtually the gross amount of such income by the commercial domicile state if by application of the apportionment formula only a small amount of the corporation's operating losses were attributed to such state.[4] For this very reason, this Court has frequently recognized that a gross receipts tax, particularly if not fairly apportioned to business activities within the taxing jurisdiction, places a far greater burden on interstate commerce than does an apportioned net income tax (*U.S. Glue Co.* v. *Oak Creek* (1918) 247 U.S. 321, 328-329; see also, *Western Live Stock* v. *Bureau* (1938) 303 U.S. 250, 255-256; *General Motors* v. *Washington* (1964) 377 U.S. 436, 440).

The rule of fair apportionment of income arising in connection with the unitary business operations of a corporate taxpayer to the states in which it conducts its business, far from being "inherently distorting" as Mobil asserts (Appellant's Br., p. 31), has long been accepted by this Court as the touchstone of constitutional adjudication in this area. Whether the income is received in the form of dividends or otherwise is of no constitutional significance. It is the substance and reality of the situation that controls, not the form (*Complete Auto Transit, Inc.* v. *Brady* (1977) 430 U.S. 274, 288). Mobil has made no showing in this case that its stocks from which the dividends in question were

[4]Under this approach, New York in the instant case could tax more than 100% of Mobil's net income. Since Mobil's dividends constituted 121% of its Federal taxable income for 1972, Mobil could be taxed in New York on more than its net income if New York were permitted specifically to allocate such dividends for net income tax purposes.

derived were not held for the purposes of its unitary petroleum business, or that the operations of its dividend-paying subsidiaries were unrelated to that business. In such a case, the "claim of the State of commercial domicile to tax in their entirety the dividends of a corporation," far from being "compelling" (Appellant's Br., p. 31), has no substantial basis at all.[5]

III. FEDERAL TAX POLICY DOES NOT PRECLUDE IMPOSITION OF A PROPERLY APPORTIONED STATE NET INCOME TAX IN ADDITION TO ANY INCOME TAX IMPOSED AT THE NATIONAL LEVEL.

Mobil's argument that the inclusion of the alleged "foreign source" dividends in the Vermont net income tax apportionment base conflicts with established Federal policy and impermissibly regulates foreign commerce not only is based on a misapplication of this Court's *Japan Line* decision, but also ignores the fundamental distinction between state income taxes and income taxes imposed at the national level.

[5]State court income tax cases cited by Mobil such as *Southern Pacific Co.* v. *McColgan* (1945) 68 Cal.App.2d 48, 156 P.2d 81 (Appellant's Br., p. 30), were primarily concerned with whether the claim of the state of commercial domicile of a corporation outweighed that of the technical "legal" domicile, and not with the resolution of competing claims to tax an apportioned share of such income by the states in which the taxpayer's business operations were actually conducted. In *Southern Pacific*, dividends were allocated to a corporation's business headquarters in California, in preference to Kentucky, the state of its legal domicile, or New York, where the dividends were received and the underlying stock held and where the Company's board of directors and executive committee held their meetings. Unlike the instant case, there was no evidence in *Southern Pacific* that any of the states in which the taxpayer conducted its unitary business operations sought to tax an apportioned share of the dividend income in question (68 Cal. App.2d 53).

In *Japan Line* this Court noted that state property taxation of foreign based and registered instrumentalities of foreign commerce might "impair federal uniformity in an area where federal uniformity is essential" and prevent the Federal government from speaking with "one voice" in the regulation of foreign commerce (47 U.S.Law Week 4481). This conclusion was based primarily on a Customs Convention signed by the United States and Japan exempting containers used exclusively in foreign commerce from "all duties and taxes whatsoever chargeable by reason of importation" (47 U.S.Law Week 4482).

There is no similar basis for concluding that a properly apportioned state net income tax constitutes impermissible state regulation or interference with foreign commerce. No treaty precludes such a tax directly or by implication.[6] As this Court noted in sustaining the application of Washington's business and occupation tax to the business of stevedoring in *Washington Rev. Dept.* v. *Stevedoring Assn.* (1978) 435 U.S. 734:

> "[T]he tax does not restrain the ability of the Federal Government to conduct foreign policy. As a general business tax that applies to virtually all businesses in the State, it has not created any special protective tariff. The assessments in this case are only upon business conducted entirely within Washington. No

[6]Contrary to Mobil's assertion (Appellant's Br., pp. 42-43), the bilateral tax treaties in force between the United States and foreign nations clearly reflect that fairly apportioned state income taxes are not viewed as an impediment to or interference with the policies and objectives sought to be achieved by the Federal government through the treaty process. No existing U.S. tax treaty limits or otherwise regulates state income taxation of domestic corporations. Even in the case of foreign corporations, the only limitation on state taxation in this area is under customary "nondiscrimination" clauses which prevent political subdivisions of the United States from levying *discriminatory* taxes on foreign corporations.

> foreign business or vessel is taxed. Respondents, therefore, have demonstrated no impediment posed by the tax upon the regulation of foreign trade by the United States" (435 U.S. 754).

Contrary to Mobil's contention (Appellant's Br., pp. 38-48), the statutory scheme under which income taxes are imposed at the national level and treaties adopted in connection therewith were never intended to limit a state's power to impose an apportioned net income tax on a multinational corporate enterprise conducting substantial business activities within its borders. Under the Federal tax laws, the entire net income of a domestic corporation, whether received from foreign or domestic "sources", is subject to Federal income tax. For that reason, as a matter of policy, in order to avoid duplicative taxation at the *national* level of earnings derived from sources outside of the United States, the Federal government allows a foreign tax credit (if elected in lieu of a deduction) for foreign income taxes paid directly by domestic corporations (I.R.C., § 901). For similar reasons, the Federal government allows a United States corporate taxpayer receiving dividends from a foreign corporation in which it holds a 10% or greater stock interest an "indirect" or "deemed paid" credit for a proportionate share of foreign income taxes paid on the underlying earnings of the foreign subsidiary out of which the dividends are paid (I.R.C., § 902). Such credits are subject to detailed limitations and, even under Federal law, may not be allowable (I.R.C., § 904). In particular, they may not exceed the amount of the Federal income tax imposed on the corporation's "foreign

source income" as determined under section 862 and 863 of the Internal Revenue Code.

Such provisions are relevant to avoid duplicative taxation of the entire worldwide income of a domestic corporation at the national level. They are irrelevant to an apportioned state net income tax, which by definition reaches only earnings fairly attributable to a corporation's activities within the borders of the taxing state. They were not intended to, and have never been interpreted as, precluding a properly apportioned net income tax at the state level. In 1973 testimony before the Subcommittee on State Taxation of Interstate Commerce of the Senate Committee on Finance (supra, p. 10), Professor Hellerstein recognized that the Federal provisions governing intercompany dividend deductions and foreign tax credits are irrelevant to the state income tax issue. He stated:

> "I should like to comment on the provision of S. 1245 which would prohibit States from taxing dividends received from 50% or more owned subsidiaries, and would bar the taxation of dividends, whether paid by subsidiaries or otherwise, which are treated as foreign source income for Federal income tax purposes * * *. The major argument made by the proponents of this restriction on the State taxing powers is that this is in substance what the Federal government does, through the intercorporate dividend exclusion and the indirect foreign tax credit. * * * *The Federal model appears to me to be irrelevant to State taxation*" (Hearings (September 18 and 19, 1973) 93d Cong., 1st Sess., p. 163) (emphasis supplied).

The provisions of the Internal Revenue Code dealing with the classification of income from sources within or

without the United States cover not only dividends but virtually all forms of income, including interest, rents, royalties, compensation for services, and sales income (see I.R.C., §§ 861-863). If Mobil's argument that the Federal policies underlying the foreign tax credit require that "foreign source" dividends receive special state tax treatment were accepted, it is difficult to see why special rules would not also be dictated for "foreign source" interest, royalties and sales income of a multinational taxpayer. Yet Mobil has not argued for this result in asserting that, as a matter of Federal policy, dividends should not be included in any state net income tax apportionment base.

State income taxes have always been imposed in addition to the Federal income tax, albeit at a fraction of the rate of that imposed by the Federal government. In imposing such a tax, a state has never been required by statute or treaty to grant a credit for income taxes paid to the United States government or to the government of any foreign country, so long as the corporation's net income was fairly apportioned to activities within the state. The fact that a credit for foreign income taxes may be allowed under Federal law with respect to items of "foreign source income" as therein defined is a matter relevant to Federal, not state, income tax policy. The imposition of a properly apportioned state net income tax, in addition to any income taxes imposed at the national level, does not constitute duplicative *state* taxation of income arising from interstate and foreign commerce. It is duplicative taxation of income *among the states* that is the concern of the commerce clause, and such duplication is precluded by a rule of fair apportionment.

CONCLUSION

For the reasons stated, the judgment of the Supreme Court of Vermont should be affirmed.

Respectfully submitted,

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